Fiscal Services Division
Legislative Services Agency
Fiscal Note

HF 858 - Bio-Diesel Enterprise Zones (LSB 1898 HV)
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Fiscal Note Version - New
Requested by Representative McKinley Bailey

Description

House File 858 makes a current investment tax credit transferable. This would allow the person or entity receiving the original tax credit to sell it to another person or entity. The tax credit involves biodiesel plants located in Enterprise Zones. The change is effective July 1, 2007.

Background

Biodiesel plants located in an Enterprise Zone are eligible for several tax credits and other federal, State and local incentives. The incentive addressed in HF 858 is equal to 10.0% of the plant investment. To date, the Department of Economic Development has approved eight plants in Enterprise Zones and the investment tax credits approved total $28.0 million. Under current Iowa law, the tax credits are divided evenly and awarded to the eligible company over the first five years of operation.

The eight biodiesel plants are likely organized either as Subchapter S corporations (S-Corps) or as Limited Liability Companies (LLCs). The profits of both types of entities flow to the owners and are taxed as individual income. Tax credits such as the 10.0% investment credit also flow through the company and are distributed to the owners based on each owner's share of profits from the company. The company does not have to be profitable for the tax credits to be used, but each owner must have sufficient Iowa income tax liability from all income sources to fully utilize the tax credits received through company ownership.

Tax credits that exceed the Iowa income tax liability of an individual owner may be carried forward for seven years, or until depleted. If each owner does not have sufficient Iowa income tax liability, the tax credits will be carried forward to future years. After the roll-forward period has passed, any unused tax credits are void. A plant owner with little or no Iowa income tax liability, such as an out-of-state investor, would be significantly limited in ability to redeem any credits earned, unless the plant distributed profits sufficient to utilize the credits as they are issued.

House File 858 would allow the tax credits to be sold by the company and the credits would therefore not flow through to the individual owners. Once sold, it is assumed the buyer will have sufficient Iowa income tax liability to utilize all purchased credits in the year first available.

For almost all tax situations, Iowa's highest effective income tax rate is 6.03% (8.98% adjusted for federal deductibility at a federal rate of 35.0%). For all eight current plants, the tax credits likely to be awarded for tax years 2008 through tax year 2011 equal $5.5 million. To fully utilize the 2008 though 2011 tax credits in the original years of issue, the owners of the plants would need a total of more than $92.0 million of income that would otherwise be taxed by Iowa for each of those years.

The largest plant approved for credits to date will receive $1,184,000 in investment tax credits for each of the first five tax years of operation. An owner with a 2.0% share of that plant will receive $23,700 in income tax credits each year for five years. To utilize that amount of tax credits on a personal income tax return, the return would need approximately $400,000 in Iowa taxable income that was not already shielded from Iowa income tax by other tax exemptions and credits.

Assumptions

- The biodiesel plants will not distribute any significant profits to the owners for at least three years after start-up.
- The first tax credits for a project are awarded for the tax year the plant becomes operational.
- The owners of all eight current plants are LLC's or S-Corps, and the owners of those entities are individuals.
- The tax credit change in HF 858 will be applied to all eight current projects and to any future projects approved by the Department of Economic Development.
- The ability of each current owner of the biodiesel plants in an Enterprise Zone to utilize that taxpayer's share of awarded tax credits is not known. It is assumed that some owners will not have sufficient Iowa income tax liability, either because they are not residents of the State for tax purposes or because of the lack of current income subject to Iowa tax. For this fiscal note, it is assumed the owners of the eight plants will have a total of $40.0 million in income each of the first three years of operation that would otherwise be taxed by Iowa. Tax credits that cannot be used in the original year of issue will roll forward for up to seven years. After three years, profit distribution from the plants will accelerate tax credit redemption.
- Under current law, it is assumed all awarded tax credits will be used prior to their expiration date.

Fiscal Impact

House File 858 will accelerate the redemption of investment tax credits, so the Bill will have an impact on the State General Fund. It is projected that the tax credit change in HF 858 will reduce net General Fund revenue for fiscal years 2008 through 2013, and increase net General Fund revenue for fiscal years 2014 through 2017.

HF 858 Fiscal Impact on Net General Fund Receipts

	Tax Credit Redemption - Current Law	Tax Credit Redemption Assuming HF 859	Net General Fund Revenue Change
FY 2008	$ 536,000	$ 1,230,000	$ (694,000)
FY 2009	2,412,000	5,540,000	(3,128,000)
FY 2010	2,412,000	5,540,000	(3,128,000)
FY 2011	2,714,000	5,540,000	(2,826,000)
FY 2012	3,317,000	5,540,000	(2,223,000)
FY 2013	3,317,000	4,310,000	(993,000)
FY 2014	3,317,000	276,000	3,041,000
FY 2015	3,317,000		3,317,000
FY 2016	3,317,000		3,317,000
FY 2017	3,317,000		3,317,000
	$ 27,976,000	$ 27,976,000	$ 0

This fiscal note is based on the eight biodiesel plants already approved by the Department of Economic Development. New plants will likely be approved in the future, and the current eight plants could possibly be enlarged. The General Fund impact of those potential developments is not included in this fiscal note.

Sources

Department of Economic Development
Legislative Services Agency Analysis
Department of Revenue

/s/ Holly M. Lyons

April 5, 2007

The fiscal note and correctional impact statement for this bill was prepared pursuant to Joint Rule 17 and pursuant to Section 2.56, Code of Iowa. Data used in developing this fiscal note and correctional impact statement are available from the Fiscal Services Division, Legislative Services Agency to members of the Legislature upon request.